

CC:ITA:DClark
POSTN-163607-01

MEMORANDUM FOR BETH SHEPERD
CHIEF, CREDIT CARD SERVICES

JAN 15 2002

FROM: Heather Maloy
Associate Chief Counsel CC:ITA

SUBJECT: [REDACTED] Delinquencies

This responds to your request for assistance with regard to the tax consequences of employees' settlement of their travel credit card debt for less than the full amount due and owing to the credit card company.

LEGEND

X
Y

[REDACTED]

ISSUE

Does an employee who has charged business travel expenses to a credit card and received full reimbursement but who settles the credit card debt for less than the full amount of the expenses have cancellation of indebtedness income pursuant to section 61(12) of the Internal Revenue Code?

CONCLUSIONS

As a general rule, unless the exclusions of section 108 apply, the saving that is realized by a debtor upon the reduction or cancellation of its outstanding indebtedness for any less than the full amount due will be income to the debtor.

FACTS

You set forth the following as the typical facts giving rise to your inquiry. X provides its employees with credit cards issued by Y for the purpose of use with employment related

PMTA : 00524

POSTN-163607-01

travel. Only the employee is responsible for charges to the card. Some employees have incurred travel expenses which they have charged to their credit card account. The employees then file claims with X for reimbursement of the full amount of the business expenses incurred. However, upon receipt of the reimbursements from X, the employees do not pay off their Y account balances. Instead, they allow the credit card accounts to become delinquent which results in Y referring the accounts to a collection agency. Subsequently, the employees settle the delinquent debts for less than the full amount owed to Y.

LAW AND ANALYSIS

Section 61(a)(12) provides that gross income means all income from whatever source derived, including income from discharge of indebtedness. Section 1.61-12(a) of the Income Tax Regulations provides that the discharge of indebtedness, in whole or in part, may result in the realization of income. Section 1.61-12(a) of the Income Tax Regulations further provides that a taxpayer may realize income by the payment of his obligations at less than their face value.

It is well-settled that the saving that is realized by a debtor upon the reduction or cancellation of its outstanding indebtedness for any less than the full amount due may be income to the debtor. U.S. v. Kirby Lumber Co., 284 U.S. 1 (1931). Here, the employees of X incurred credit card debt in the amount of the travel expenses plus interest which accrues during the delinquency period. The cancellation of debts under a settlement agreement gives rise to income. Exchange Security Bank v. United States, 492 F.2d 1096 (5th Cir. 1974). Upon settlement of the debt for an amount less than the face amount due to Y, the difference between the amount due and the amount paid for the discharge may be taxable income to the employee, unless the exclusions of § 108 are applicable (e.g. the debtor is insolvent).

cc: Mark S. Kaizen
Associate chief Counsel (General Legal Services) CC:GLS
ATTN: R. Hall